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SOUTHWEST GAS CORPORATION

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AZ CORP COMMISSION
Arizona Corporation Commission
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Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, AZ 85007-2996

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RE: DECOUPLING MECHANISM REPORT (DOCKET NO. G-01551A-04-0876, DECISION NO. 68487)

Please find an original and 13 copies of Southwest Gas Corporation's (Southwest) report on its efforts to pursue implementation of a decoupling mechanism through discussions with Utilities Division Staff (Staff), the Residential Utility Consumer Office (RUCO), and the Southwest Energy Efficiency Project (SWEEP) in compliance with the Arizona Corporation Commission's (Commission) directive in Decision No. 68487, dated February 23, 2006. The Commission on page 34 of its Decision stated:

We encourage the parties to this proceeding to seek rate design alternatives that will truly encourage conservation efforts, while at the same time providing benefits to all affected stakeholders. To that end, Southwest Gas should coordinate its efforts to pursue implementation of a decoupling mechanism through discussions with Staff, RUCO, SWEEP/NRDC, and any other interested parties. Such efforts may be pursued through the DSM policy process, as suggested by SWEEP/NRDC, and through a proposal in the Company's next rate case.

Decoupling as used in this context means reducing or removing the relationship between gas consumption and fixed cost recovery.

Background

At the time Southwest made its first decoupling proposal in its last general rate case, the American Gas Association (AGA) and the Natural Resources Defense Council (NRDC) had just issued a joint statement in support of automatic rate true-ups to ensure that a utility's opportunity to recover authorized fixed costs was not affected by fluctuations in sales. The National Association of Regulatory Utility Commissioners (NARUC) subsequently issued



its Resolution in support of the AGA/NRDC joint statement. Since that time, many more states have adopted some form of decoupling. There has also been a national response to the challenges of addressing the need for energy efficiency and the mitigation of utility financial impacts. This response has included the following policy directives:

- Arizona Governor Janet Napolitano signed "Executive Order 2006-13" establishing statewide reductions in greenhouse gas emissions in part through increased energy efficiencies and reducing energy demand by consumers and businesses.
- The Department of Energy (DOE), in its report to Congress on "State and Regional Policies That Promote Energy Efficiency Programs Carried Out by Electric and Gas Utilities", recommended that regulators consider modifying policies to align utility incentives with the delivery of cost-effective energy efficiency by addressing the typical utility throughput incentive and removing other regulatory and management disincentives to energy efficiency. The DOE also recommends that regulators should consider modifying ratemaking practices to promote energy efficiency among consumers, while recognizing that this goal must be balanced with other ratemaking objectives.
- The Environmental Protection Agency's (EPA) "National Action Plan for Energy Efficiency" recommends policies be modified to align utility incentives with the delivery of cost-effective energy efficiency and ratemaking practices to promote energy efficiency investments. NARUC endorsed the National Action Plan in its August 2, 2006 resolution and stated that "...it recommends to its member commissions a state-specific and where appropriate, regional review of the elements and potential applicability of the energy efficiency policy recommendations outlined in the Plan, in an effort to identify potential improvements in energy efficiency policy nationwide."¹
- On June 22, 2007, the U.S. Senate passed H.R.6, the "Renewable Fuels, Consumer Protection, and Energy Efficiency Act of 2007". This Act is designed to reduce the Nation's dependency on foreign oil by investing in clean, renewable, and alternative energy resources, promoting new emerging energy technologies, developing greater efficiency, and creating a Strategic Energy Efficiency and

¹ NARUC Resolution Supporting the National Action Plan on Energy Efficiency, NARUC 2006 Summer Meeting.



Renewables Reserve to invest in alternative energy. Among its policy directives, H.R.6 encourages gas utility rate design modifications that promote energy efficiency through separating fixed-cost revenue recovery from the volume of transportation or sales service provided to utility customers.

- In its April 2006 briefing paper on "Revenue Decoupling for Natural Gas Utilities", the National Regulatory Research Institute concluded that state commissions should consider a revenue decoupling mechanism for gas utilities that are required to promote cost-effective energy efficiency programs. The author also concludes that revenue decoupling has merit if there is uncertainty of future gas consumption and that gas use per customer will likely decline in the future.

An American Gas Association summary of various states' responses to these policy directives is attached to this report as Exhibit 1.

Stakeholder Meetings

Southwest, Staff, RUCO and SWEEP met on four occasions: September 18, 2006, November 30, 2006, January 24, 2007 and April 4, 2007. The meetings were held to explore options available to stabilize Southwest's cost recovery without negatively impacting efforts to promote conservation and energy efficiency. The Stakeholders discussed methods that would accomplish decoupling to various degrees including:

- Traditional Rate Design
 - Increased Fixed Charges (recover more fixed costs in a fixed rate)
 - Declining Block Rates (recover more fixed costs in the first level of use)
- Revenue per Customer Balancing (rate adjustments to meet an authorized fixed cost/customer target)
- Weather Normalization Mechanism (adjusts customer billing units for weather variations)

Increased Fixed Charges and Declining Block Commodity Rates

In the above referenced meetings, Southwest generally expressed its belief that traditional gas utility rate designs encourage utilities to maintain customer usage levels in an effort to recover Commission-authorized costs of service. Although having a greater amount of cost recovery in the fixed charge and first



commodity block improves or reduces some of the uncertainty associated with fixed cost recovery, as long as fixed costs remain in the commodity rates, the utility's financial incentive is to maintain, rather than to reduce, the amount of gas delivered to customers. The greater the amount of the fixed cost of providing distribution service recovered in a commodity-based rate structure, the greater the disincentive there is for the utility to aggressively promote conservation and energy efficiency. In order to completely remove the disincentive with rate design, all fixed costs should be recovered in fixed charges, absent a full margin decoupling mechanism.

Revenue per Customer Balancing

In the initial meeting, SWEEP arranged for the Regulatory Assistance Project (RAP) to give a presentation on decoupling. RAP is a non-profit organization funded by the Energy Foundation, U.S. DOE and U.S. EPA to provide assistance to state government officials on utility regulation. RAP is an independent organization dedicated to the public interest and does not represent or consult for private interests or utilities. RAP's preferred decoupling strategy is to establish Revenue Per Customer (RPC) tracking and balancing. The RPC mechanism tracks differences in the amount of revenue per customer authorized in a rate case and the amount actually recovered from customers.

There was extensive discussion on the RPC mechanism in the Stakeholder meetings. Although there was agreement among the participants that an RPC-type mechanism would free the Commission to make whatever changes to rate design it deems appropriate without adversely impacting the utility's cost recovery, not all participants agreed on the merits of implementing such a mechanism.

Weather Normalization Mechanism

Weather Normalization Mechanisms (WNM) adjust customer billing units to reflect deviations from normal weather. These adjusted billing units are used to calculate the non-gas portion of a customer's bill. Such mechanisms are symmetrical in their benefit to both the customer and the utility by stabilizing customer bills and the recovery of authorized fixed costs.

Although Southwest is of the belief that a WNM would benefit both customers and the utility, not all participants agreed on the merits of implementing a WNM mechanism.



Results and Conclusion

The Stakeholders examined the dollar impact(s) on Southwest's residential customers' bills and on total residential revenue of changes in sales related to both weather and customer conservation. Weather-related changes in residential revenues move in both directions and tend to even out over time. Conservation-related losses in revenues are reduced through the general rate case process when rates are "reset" to reflect current test year use. However, conservation-related losses increase in the years between rate case with continued declines in use per customer.

Although Southwest presented evidence that both weather-related and conservation-related changes in residential use per customer can affect residential margin revenue by as much as eight (8) percent annually, there was no consensus on a decoupling strategy for Southwest. Therefore, in its next general rate case filing, Southwest will propose rate design alternatives that address weather- and conservation-related changes in revenue and cost recovery.

Southwest is appreciative of the Commission's efforts to encourage the Stakeholder meetings, and believes that the information presented in this Report will assist the Commission in its evaluation of future rate design and decoupling proposals for Southwest.

Respectfully submitted,

Debra S. Jacobson, Director
Government & State Regulatory Affairs

c Compliance Section, ACC

Southwest Gas Corporation

**Decoupling Mechanism Report
Docket No. G-01551A-04-0876
D.68487**

Exhibit 1

NATURAL GAS Rate Round-Up

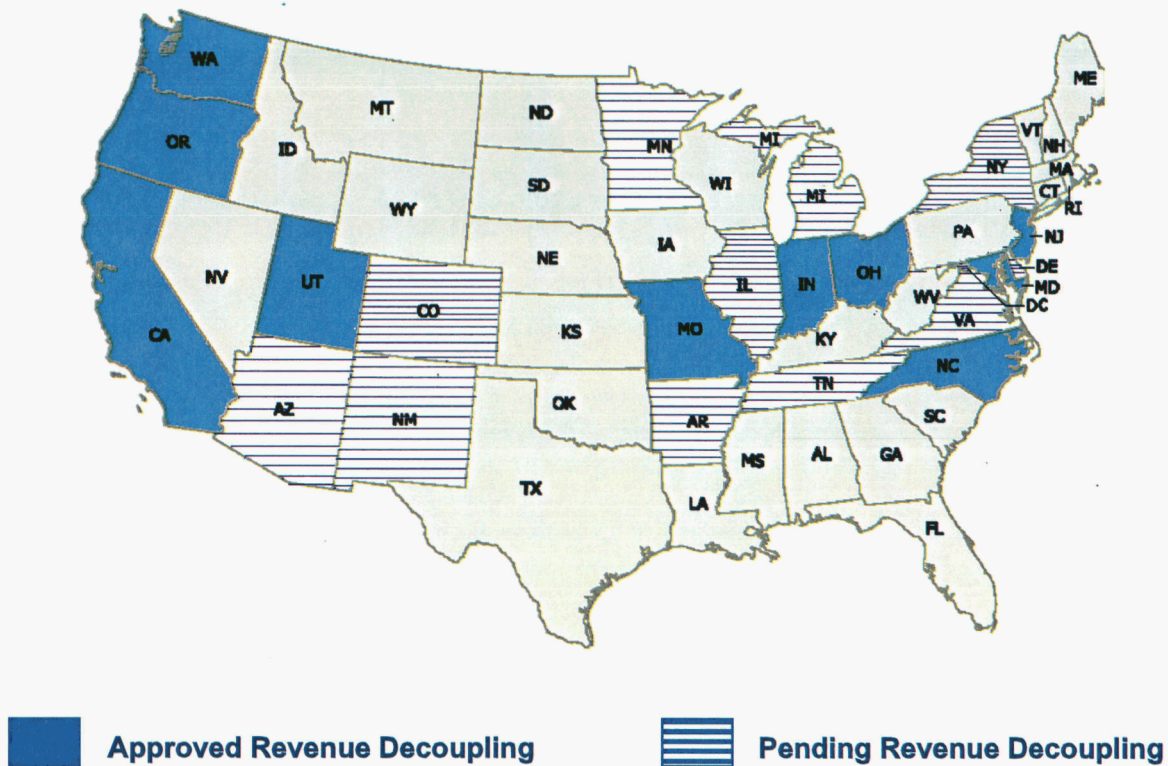
A Periodic Update on Innovative Rate Designs

April 2007

Update on Revenue Decoupling Mechanisms

This Rate Round-Up provides an updated and expanded edition of revenue decoupling reports that AGA issued in 2006 and 2005. Currently, 17 utilities in 10 states have implemented decoupling tariffs that serve 15 million residential customers. Decoupling programs are pending in another 10 states, plus the District of Columbia, potentially serving another 6 million residential customers. Revenue decoupling is a rate design method that allows utilities to actively promote energy efficiency while preventing the erosion of margins that is the usual outcome of customer conservation and utility energy efficiency.

STATES WITH NATURAL GAS REVENUE DECOUPLING TARIFFS



DESCRIPTIONS AND COMPONENTS

Decoupling Rate Design

Natural gas customers and society in general would benefit from greater energy efficiency, and there is general agreement that natural gas utilities are key players in delivering energy efficiency programs and savings to customers. However, natural gas utilities traditionally face a powerful disincentive to promoting increased energy efficiency. The good news is that this disincentive was put in place by utilities and public utility commissions and can be removed. A win-win solution is possible that benefits both customers and utilities, and will lead to far greater energy efficiency.

The problem is simple. Gas utilities are in a fixed-cost business. The costs of the distribution service that they provide do not vary greatly in relation to the amount of gas that the utilities' customers consume. Since this is so, gas utilities should be supportive of customer conservation. However, gas utilities are rate regulated by state public utility commissions and the typical utility rate design in place today penalizes utilities if customers become more energy efficient. Most utilities use a 100-year-old rate design that recovers the fixed costs of a fixed cost business, not on a fixed, per customer basis, but on a volumetric basis. This means that under traditional utility rate design, a utility's earnings and profits will decline if customers conserve.

The solution is also simple. Many states, as well as federal policy makers, now discourage increased natural gas sales and encourage energy efficiency and conservation. Consequently, several states have put in place rate mechanisms that separate, or "decouple", the recovery of fixed distribution system costs from the volume of gas delivered to customers. Revenue decoupling allows the utility to actively promote conservation and energy efficiency without having to sacrifice its financial stability. Revenue decoupling works by adjusting the actual sales volumes to the weather-normalized sales volumes approved during the last rate case. When sales volumes deviate from the level forecasted in the rate case, the true-up mechanism makes a modest adjustment to the distribution charge, which gives the utility an opportunity to recover its authorized fixed costs regardless of fluctuations in energy use.

Energy Efficiency and Conservation Tariffs

The natural gas industry has been a national leader in energy efficiency. Today, the average American home uses about 25 percent less natural gas than it did a quarter century ago. The reduction in per-capita natural gas use has been driven primarily by energy efficiency. Homeowners have conserved by adding storm windows, insulation and weather stripping to their homes. Over the past 25 years, gas appliances have become enormously more efficient. Moreover, new construction, although producing increasingly larger homes, has also produced increasingly energy-efficient homes.

Utility-sponsored customer conservation and energy efficiency mechanisms provide consumers with an incentive to conserve natural gas, or provide education to consumers on how to conserve natural gas. Decoupled rates have been associated with strong energy efficiency programs, and conservation and energy efficiency are being addressed in each decoupling proceeding. Decisions about the inclusion of conservation components and energy efficiency programs within a decoupling program are usually based on the effectiveness of existing energy efficiency programs, the relative satisfaction with existing programs, and the relative desire to push for more aggressive energy efficiency programs—and this all varies by state. Not all decoupling tariffs include a utility-sponsored conservation component.

Not all utility-sponsored conservation and energy efficiency programs include a decoupling mechanism. At least 29 natural gas utilities have energy efficiency tariffs or conservation provisions that allow recovery of conservation and demand-side management program costs, as well as recovery of lost net revenues caused by the reduction in sales. The programs differ in what costs are allowed recovery (e.g., program costs, administrative costs, lost margin costs), and who administers the program (e.g., company, state, or charitable organization). One example is NW Natural, which includes a conservation component in its current decoupling mechanism that is administered by an outside charitable foundation. Another example is Vermont Gas, which does not have a decoupling program, but does have a Demand Side Management and Energy Efficiency program, in which the utility funds a portion of customers' costs of purchasing new, more energy-efficient appliances. Vermont Gas defers the costs of the program until its next rate case, subsequently amortizes the costs over a three-year period, and charges the costs to all ratepayers.

Computing the Adjustment and Accounting for Increases in Customer Count

There are several options for calculating the revenue adjustment, or true-up, and while the results are approximately the same, the different options help companies meet unique regulatory preferences and circumstances. The use-per-customer basis makes a rate adjustment that is based on changes in average use per customer, and then applies that adjustment factor against unit margins by customer class. The margin-per-customer rate adjustment is based on the change in baseline marginal revenue per customer compared to the actual marginal revenue per customer. The total margin revenue adjustment is based on comparison of total baseline marginal revenues to actual marginal revenues.

In order to remove the financial disincentive to promoting energy efficiency and conservation, marginal revenues from new customers are retained by the utility. The rate case level of fixed costs has been based on expenses and return on rate base that matches the rate case number of customers, and those costs do not reflect the additional operating costs and return on rate base arising from the addition of new customers to the utility. The fixed costs from those customers can only be recovered through the margins generated by sales to those new customers. Therefore, prior to determining the revenue adjustment, the amount of actual revenue is adjusted by the level of marginal revenue from new customers.

Return on Equity Considerations

Decoupling is a fair and efficient means to design utility rates from the customer's perspective. The change in rate design decouples the recovery of the utility's return on equity from the volumes of natural gas commodity consumed by the utility's customers. The symmetrical nature of decoupling prevents the utility from increasing its earnings by increasing its delivered volumes because any additional distribution charges collected by the utility in that event are refunded to customers. Moreover, decoupling does not shelter the utility from the impact of increased costs and/or provide a guarantee that the utility will achieve its authorized return.

Return on equity is established at a level that allows the utility to compete for the attraction of capital with other companies of similar risk profile, and to pay investors a fair return on their investment. Factors that are considered in equity return determinations have seldom, if ever, included rate design, and prior to the advent of innovative rates, rate designs seldom, if ever, included a premium for their possibly risky rate designs. The utility's peer group that is used for the return on equity determination may already include companies whose rate designs are all or partially non-volumetric in design. Decoupling is not incentive regulation and it does not provide a bonus or an incentive that can be earned or awarded to the company.

Similar Non-Volumetric Rate Design Mechanisms

More than one rate design method exists that will break the link between volumes of gas consumed and cost recovery for the utility. Fixed variable rate design places all of the utility's fixed costs, including a regulated profit on the value of the utility's investment in plant and equipment used to provide service to the customer, into a fixed monthly charge called a service charge or a demand charge. This charge is similar to the monthly fee charged by cable TV companies and is unrelated to the amount of gas (or number of TV programs) used by the customer. Utilities in four states currently utilize a fixed charge type of rate design for recovery of their costs. AGA discussed this rate design mechanism in the June 2006 Rate Round-Up http://www.aga.org/Template.cfm?Section=Rate_Roundup&Template=/MembersOnly.cfm&ContentID=20563.

Rate stabilization is another rate design mechanism that decouples a utility's profits from its gas throughput. The mechanism works by adjusting the utility's monthly revenues up or down to meet pre-established revenue and return targets. The amount calculated is added to or subtracted from the commodity charge of the utility in the next month, and the utility files a revised rate schedule with the regulator. Natural gas utilities in six states have received approval for these mechanisms. The December 2006 Rate Round-Up at http://www.aga.org/Template.cfm?Section=Rate_Roundup&Template=/MembersOnly.cfm&ContentID=20563 discussed these mechanisms in more detail.

Conclusions

While decoupling imposes no additional costs to the customer beyond those approved in the rate case, the mechanism leads to reduced customer bill variability from stabilized fixed cost recovery. Most important, since the biggest portion of a customer's gas utility bill is the cost of natural gas, greater energy efficiency and conservation lead to significantly lower utility bills. Lower bills also lead to lower bad debt expense, which is a system cost paid by all customers. Finally, reduced overall gas demand could lead to lower natural gas prices.

An independent evaluation of one decoupling tariff¹ found the program to be worthwhile and in the public interest. Among the conclusions of the evaluators were that the mechanism is effective in reducing the variability of utility revenues; the mechanism removes disincentives to promote energy efficiency; decoupling changes the company focus from sales advertising to conservation advertising; the mechanism does not reduce the incentive for good customer service; public purpose funding established in conjunction with the conservation component is beneficial to consumers; and the mechanism does not shift risk to customers.

While traditional rate designs contain a financial disincentive that prevents utilities from aggressively promoting energy efficiency and conservation, revenue decoupling breaks the link between a utility's earnings and energy consumption of its customers without adding any additional customer charges beyond what was approved by regulators. States should energetically consider implementing this innovative rate design.

¹A Review of Distribution Margin Normalization as Approved by the Oregon Public Utility Commission for Northwest Natural, Christensen Associates Energy Consulting, LLC, March 2005.

CURRENT REVENUE DECOUPLING PROGRAMS

◆ APPROVED

1. CA – Pacific Gas and Electric
2. CA - San Diego Gas and Elec.
3. CA – Southern California Gas
4. CA – Southwest Gas
5. IN – Vectren Indiana
6. MD – Baltimore Gas and Elec.
7. MD – Washington Gas
8. NJ – NJ Natural Gas
9. NJ – South Jersey Gas
10. MO – Atmos Energy
11. OH – Vectren Ohio
12. OR – Cascade Natural Gas
13. OR – NW Natural Gas
14. NC - Piedmont Natural Gas
15. UT – Questar Gas
16. WA – Avista Corp.
17. WA – Cascade Natural Gas

◆ PENDING

1. AR – CenterPoint Energy
2. AZ – UNS Gas
3. CO – PSC of Colorado
4. DC – Washington Gas
5. IL – Peoples Gas/Integrus
6. MI – CMS Energy
7. MN – Xcel Energy
8. NM – Public Service Co. of NM
9. NY – National Fuel Gas Distribution
10. TN – Chattanooga Gas
11. VA – Washington Gas Light

California - Pacific Gas and Electric

The only state that has adopted decoupling for both natural gas and electric utilities is California. With the goal of encouraging conservation and with broad stakeholder support at the time, Pacific Gas and Electric (PG&E) decoupled natural gas sales in 1978 and electric sales in 1982. In the 1970s, the California PUC mandated inverted block rate design (increasing levels of consumption are charged higher rates) to encourage customer conservation. However, an inverted rate structure magnifies the impact on revenues of weather, conservation, price elasticity and other sales changes. Decoupling allows pricing signals to customers without revenue loss or gain to the company. The revenue decoupling mechanism is paired with an annual attrition mechanism that adjusts annually for customer growth, inflation, and replacement of aging infrastructure facilities. To address the huge escalation of natural gas costs in the winter after Hurricane Katrina, PG&E deployed several initiatives that encouraged conservation but that reduced its natural gas transportation revenues by \$47 million. Without decoupling, the conservation program would have had a negative impact on PG&E's financial performance and very likely would not have been proposed. Today, nearly all of PG&E's revenues are decoupled, with only about 4 percent of natural gas revenues at risk, and support continues to be widespread among stakeholders throughout the state.

California - Southwest Gas

California has had some variation of a decoupling program in place for most of its utilities for nearly 30 years. The impetus for the program was the enactment of lifeline rates legislation, gas supply constraints, and the adoption of demand side management programs by the state. In its most recent general rate case order, effective April 15, 2004, Southwest Gas was granted authority to implement a decoupling mechanism for all customer classes. The decoupling mechanism utilizes a balancing account to protect customers if base revenues exceed authorized levels, and to protect stockholders if base revenues are less than authorized levels. The program is firmly established and utilizes a long-standing regulatory construct that does not recognize an explicit reduction to ROE.

Future test year system annual revenue requirement (margin) is established in a rate case as a fixed dollar amount on a monthly and annual basis. The difference between billed margins and authorized margins, plus carrying costs, is recorded monthly in a deferred account. The account balance is amortized annually through a uniform cents-per-therm rate applicable to all schedules, except special contracts. The test year margin amount increases each January 1 (between rate cases) according to an established formula.

California - Southern California Gas and San Diego Gas and Electric

The decoupling programs at Southern California Gas and at San Diego Gas and Electric are similar to the programs at Southwest Gas and at Pacific Gas and Electric. The decoupling programs at the California utilities apply to all customer classes, including industrial customers.

Indiana - Vectren

Vectren Energy Delivery's decoupling mechanism consists of two interrelated components: the conservation funding rider, and the decoupling mechanism. The company filed a petition rather than a new rate case for the conservation program and settled the filing in 2006. The Energy Efficiency Funding Component is assessed to residential and general service (commercial, small industrial) customers, although Vectren is financing a few items itself.

Maryland - Baltimore Gas and Electric and Washington Gas Light

BG&E's decoupling program began as part of a 1998 base rate case and is a "full decoupling" program, in that it is designed to recover multiple sources of margin loss, including weather and price elasticity, as well as losses caused by customers' conservation and energy efficiency. The Maryland decoupling mechanism utilizes a balancing account that returns to customers excess margin when revenues exceed authorized levels. A conservation component is separate from the decoupling mechanism, which applies to residential and general service firm customers.

BG&E makes adjustments to the delivery price of gas under the applicable schedules to reflect test year base rate revenues established in the latest base rate proceeding, after adjustment to recognize the subsequent change in the number of customers from the test year level. Test year average use per customer is multiplied by the net number of customers added since the like-month during the test year. The product is added to test year revenue to restate test year revenues for the month to include the revised values. Actual revenues collected for the month are compared to the restated test year revenues, and any difference is divided by estimated sales for the second succeeding month to obtain the adjustment to the applicable delivery price. Any difference between actual and estimated sales is reconciled in the determination of the adjustment for a future month. Details of the calculation of the billing adjustment are filed monthly with the public service commission.

In October of 2005, Washington Gas Light implemented a decoupling mechanism outside of a rate case that is similar in design to the decoupling program of Baltimore Gas and Electric. The Washington Gas program applies to all firm customer classes and does not have a conservation component as part of the mechanism.

Missouri - Atmos Energy

The Missouri Public Service Commission issued an order on February 22, 2007, in the base rate case of Atmos Energy Co., and adopted the commission staff's recommended revenue decoupling rate design. Atmos had filed for weather normalization rather than for decoupling. The new rates will apply to residential and small commercial customers with less than 2,000 Ccf annual consumption. The mechanism includes a requirement to spend 1 percent of annual gross non-gas cost revenues on conservation initiatives including energy audits. A collaborative

approach among company, staff, and the public counsel will be used to develop the conservation programs, which are scheduled to be implemented on August 31. The new rates took effect on April 1, 2007.

New Jersey - New Jersey Natural Gas and South Jersey Gas

On October 12, 2006, the New Jersey Board of Public Utilities (BPU) approved requests by New Jersey Natural Gas Co. and South Jersey Gas Co. to replace their existing weather normalization clauses (WNC) with a conservation incentive program (CIP) that would capture gross margin variations related to both weather and customer usage. The three-year pilot programs, which were initiated outside of a base rate case, apply to residential and most commercial customers, who will be segregated in distinct groups to avoid any cross subsidization. The decoupling mechanisms include new conservation programs that will be funded by the company, with additional programs expected to be added during the three year pilot. New Jersey Natural will spend at least \$2 million on the new customer conservation efforts, and South Jersey Gas will spend at least \$1.2 million.

As with the old WNC calculation, gross margin deficiencies attributable to conservation and other non-weather-related factors will be recovered from customers in the subsequent year through the CIP Rider. However, annual recoveries based on those deficiencies will be limited to a level of agreed-upon gas supply savings. For New Jersey Natural, the initial level of agreed upon savings will be \$10.6 million for each year of the pilot. This amount has been realized by releasing capacity, with BPU approval, from New Jersey Natural Gas to NJR Energy Services, the wholesale energy services subsidiary of New Jersey Resources.

The new decoupling program features a return on equity test that prevents New Jersey Natural from recovering any portion of a CIP deficiency charge that would cause the company to earn in excess of its authorized return during the pilot period. The company will have an independent third-party provide a comprehensive evaluation of the effectiveness of the initial two years of the program and will file a report with the BPU no later than April 1, 2009. The BPU may extend, modify or terminate the program at the end of the three-year pilot and if the program is not extended, the WNC program would be reinstated. The program at South Jersey is nearly identical to the New Jersey Natural decoupling program.

North Carolina - Piedmont Natural Gas

This decoupling tariff, approved by the North Carolina Utilities Commission in the company's November 2005 rate case, gave Piedmont Natural Gas permission to implement a Customer Utilization Tracker (CUT). The mechanism was approved as an experimental, provisional tariff for a period of no more than three years and will automatically terminate on November 1, 2008, unless renewed in a general rate case. During the life of the CUT, Piedmont has agreed to contribute \$500,000 per year toward conservation programs. Adoption of the CUT also resulted in the elimination of the company's existing weather normalization adjustment mechanism. In the 2005 ruling, the commission established an approved margin per customer per month for each residential and commercial rate class. Differences between the approved levels and the actual recovery are tracked monthly in a deferred account and trued-up twice a year. The mechanism applies to residential and commercial customers.

The North Carolina attorney general appealed to the state Supreme Court to overturn the commission action. In July of 2006, Piedmont negotiated a settlement with the attorney general in which the company agreed to an additional contribution of up to \$1,500,000 per year, dependent upon the level of conservation related revenues received by the company through

the CUT mechanism. The (up to) \$1,500,000 will be split 50/50 between a direct reduction in customer rates and further contributions to conservation programs, over and above the \$500,000 per year contribution to conservation agreed to in the tariff.

Ohio - Vectren

In September 2006, Vectren Energy Delivery received approval from the Ohio Public Utility Commission to implement a conservation tracking mechanism that is designed to provide customers with tools and information to assist them in reducing their energy costs from the level of costs that would otherwise exist absent the program. The program will operate for a minimum of two years and will receive funds from the utility, gas supply portfolio management proceeds, and reduced customer arrearages. The decoupled sales component will recover the difference between actual revenues and revenues approved in the last rate case. The company's most recent rate case came 10 months before the filing, which was settled in April of 2006. The mechanism is assessed to residential and general service (commercial, small industrial) customers.

Oregon - NW Natural

The Public Utility Commission of Oregon approved a decoupling tariff for NW Natural in September of 2002. The PUC said the tariff was designed "to break the link between an energy utility's sales and its profitability, so that the utility can assist its customers with energy efficiency without conflict." The tariff was a partial decoupling mechanism that allowed NW Natural to defer and then amortize 90 percent of the margin differentials for the residential and commercial customer groups. The mechanism contained two components: 1) a "price elasticity" factor that adjusted for increases or decreases in consumption attributable to annual changes in commodity costs or periodic changes in the company's general rates; and 2) a decoupling adjustment calculated on a monthly basis that accounted for deviations in expected volumes. Weather related risks were not covered by the mechanism. The additional company revenues or credits to customers produced by the mechanism were booked to a deferral account that was reconciled as part of the company's annual purchased gas adjustment.

The NW Natural decoupling tariff was put in place for three years on a pilot basis and had a sunset date of September 30, 2005, unless extended by the PUC. In March of 2005, NW Natural asked the PUC to investigate whether the decoupling tariff should continue. As part of the petition, NW Natural submitted the results of an independent study that had been required under the original order.

In August 2005, the Oregon PUC extended NW Natural's partial decoupling mechanism for an additional four years. NW Natural revised the decoupling schedule to provide for 100 percent deferral and amortization of the margin differentials. This change eliminated the non-weather related margin variability related to distribution fixed costs. In addition to the decoupling provisions, NW Natural currently has in effect a weather-adjusted rate mechanism (WARM) that was adopted in an earlier rate case and that lasts until September 30, 2008. The WARM covers all residential and small commercial customers, unless the customers opt out. The 2005 decoupling case dictates that public purpose funding and low-income assistance programs will remain in effect throughout the life of the decoupling program. In addition, industrial customers will not be charged or be eligible for any of the assistance programs.

NW Natural has a conservation component to its decoupling program that provides an indirect efficiency incentive to its customers. The company collects from all of its residential and commercial customers a "public purpose" surcharge of 1.5 percent of their total monthly bills. The funds are then passed on to an independent, non-profit organization, the Energy Trust of

Oregon. The Energy Trust, which also receives funding from public purposes surcharges from all of Oregon's electric utilities, then provides grants to promote energy efficiency and renewable resources among homes and businesses.

The Energy Trust of Oregon disburses approximately \$6 million each year to encourage more efficient use of natural gas. Incentives include: \$450 - \$825 per unit to builders of new home construction if natural gas service is installed; rebates for high-efficiency gas furnaces, water heaters (including tankless units) and other appliances in existing homes; rebates on insulation, new windows and other efforts to reduce home energy use; and rebates on the installation of tankless water heaters, efficient boilers, etc., in commercial buildings.

Oregon - Cascade Natural Gas

Cascade Natural Gas' decoupling mechanism was approved by the Oregon Public Utility Commission on April 19, 2006. The mechanism, which was implemented outside of a rate case, applies to residential and commercial customers, and mitigates demand reduction caused by conservation. The mechanism also adjusts symmetrically for deviations from normal weather. The Conservation Alliance Plan consists of two deferral accounts, one that tracks monthly weather-normalized usage impacts on margins, and another that tracks monthly non-weather related changes in usage on margin. The deferral accounts will be maintained as regulatory assets or regulatory liabilities and will be amortized over the following year as increments to the commodity charge. The Cascade decoupling program includes a 0.75 percent public purpose surcharge to customers and a 0.75 percent of revenue contribution from the company to fund conservation programs for customers.

The Cascade Natural Gas decoupling mechanism imposes service quality requirements, and includes a penalty provision for failing to perform below specified ratios on customer complaints. While there was no reduction to allowed ROE, Cascade's current earnings sharing mechanism was modified to reduce the threshold amount for earnings sharing from baseline ROE plus 300 basis points, to baseline ROE plus 175 basis points. If requested by the commission, the company must file a general rate case in 2008. The plan will remain in effect until September of 2010 and an independent evaluation of the program will be conducted for the parties.

Utah - Questar Gas

Questar Gas received approval for a Conservation Enabling Tariff on October 6, 2006. The three-year pilot program was the result of a four-year process that included numerous task forces and stakeholder groups. The program applies only to the general service class (residential and small commercial) customers and requires the company to aggressively pursue demand side management goals and to fund low-income weatherization programs. The company was granted full decoupling and also kept its previously authorized weather normalization adjustment clause. The program was implemented outside of a rate case.

Washington - Avista

On February 1, 2007, Avista received approval from the Washington Utilities and Transportation Commission to implement a partial decoupling mechanism on a three-year pilot basis. The program, which does not include losses related to weather, will apply to residential and small commercial customers, and rate increases from the program will be capped at 2 percent per year. The company had recently completed a rate case when it filed its petition.

Avista is to defer 90 percent of the non-weather-related margin difference (positive or negative), which is to be recovered from or returned to customers. The recovery of any deferred costs is subject to both an earnings test that would prohibit collection if Avista is earning above its

authorized 9.11 percent rate of return, and a demand-side management (DSM) test that would prohibit collection if specific conservation targets are not achieved. Funds not recovered due to the earnings and/or DSM tests may not be carried over to the next period. Also, the commission prohibits Avista from earning interest on deferrals until the deferrals are approved for recovery.

Avista must submit an evaluation of the mechanism and any proposed modifications if it wishes to continue the program after three years. The commission stated that the mechanism will be evaluated, and extension granted, only if there is a demonstration that the mechanism led to cost-effective enhanced conservation.

Washington - Cascade Natural Gas

On January 12, 2007, the Washington Utilities and Transportation Commission authorized Cascade Natural Gas to implement a partial decoupling mechanism on a pilot basis for a three-year period. The mechanism, which will apply to residential and general service commercial customers, would defer non-weather-related margin variances (e.g., changes in usage related to conservation and energy efficiency improvements). In connection with the decoupling mechanism, the settlement called for Cascade to submit a conservation plan, which would be filed after the settlement was approved and an advisory group was convened to review an outside consultant's assessment of the energy efficiency potential in the company's service territory. The settlement specified that the plan would contain targets and benchmarks based on recommendations from the advisory group, and opportunities for penalties and/or incentives. Cascade's program includes paying for customer incentives on rebates for cost-effective demand side management programs, such as high efficiency appliances, insulation and consumer education programs. The decoupling program will be subject to commission approval of a conservation plan, with earnings capped at the authorized 8.85 percent overall rate of return, and will include penalties for failure to meet conservation targets and benchmarks. The pilot program will be evaluated regardless of whether the company seeks to continue the program after the three-year period expires.

This case was a follow up to the company's previous proposal before the Washington commission. In May 2005, the commission issued a proposal to decouple utilities' gas volume sales from their recovery of fixed costs. As part of the proceeding, the commission considered a decoupling petition by Cascade Natural Gas that was outside of a rate case. The commission ultimately denied the petition and said that the issues were better considered within a rate case.

PENDING DECOUPLING MECHANISMS

Arizona – UNS

UNS Gas has asked the Arizona Corporation Commission to design rates to recover a greater share of the company's fixed costs through a higher fixed customer charge, establish a decoupling mechanism, and approve a new demand side management (DSM) program, plus a charge to fund the DSM mechanism. UNS serves customers in a geographically diverse region, and the current rate design provides a subsidy from ratepayers in colder areas to ratepayers in warmer areas. The higher fixed customer charge component will reduce this inequity, while the decoupling mechanism will true-up the remaining volumetric charges to levels anticipated by test-year usage.

Arkansas – CenterPoint Energy

[On January 16, 2007, CenterPoint Energy Arkansas Gas filed a base rate case and proposed to implement a Trial Billing Determinant Adjustment Clause (TBDAC) Rider, to mitigate the impact of reduced customer natural gas usage on company revenues. While the company supports the Arkansas commission's efforts to implement energy efficiency program guidelines for the state's utilities, CenterPoint feels that the current rate design creates a very strong economic disincentive for the company to support those energy efficiency programs. A final PSC decision is expected in mid-November.

Colorado – Public Service Co. of Colorado (a Unit of Xcel Energy)

As part of a rate case, Public Service Co. of Colorado has proposed to implement a partial decoupling rate adjustment (PDRA) clause to reflect the annual non-weather related effect of the change in average actual use per customer from the average use per customer used in the company's last rate case. The PDRA is a per therm rate adjustment for residential customers and has been proposed as a three year pilot program. No conservation component has been proposed as part of the pending rider, however, pending legislation in Colorado would mandate gas demand side management. A decision is expected in August of 2007.

District of Columbia – Washington Gas Light

Washington Gas filed a rate case on December 15, 2006, in which it proposed to implement a revenue normalization adjustment mechanism similar to its decoupling program in Maryland. That program is designed to recover multiple sources of margin loss, including weather and price elasticity, as well as losses caused by customers' conservation and energy efficiency. The decoupling mechanism will utilize a balancing account that returns to customers excess margin when revenues exceed authorized levels. An energy efficiency communication component has been proposed as part of the rate case and not specifically part of the decoupling mechanism, which applies to firm and interruptible customers. A decision is expected in September of 2007.

Illinois – Peoples Gas and North Shore Gas (Units of Integrys Energy Group)

On March 9, Peoples Gas Light & Coke and North Shore Gas filed a base rate case with the Illinois Commerce Commission and asked for approval of a decoupling mechanism under which rates would be adjusted to exclude the impact on margin of variations in weather, customer participation in conservation programs, and other factors. The companies are also proposing separate energy efficiency programs, to be funded at a level of \$7.5 million and recovered through a rider.

Michigan – CMS Energy

On February 9, 2007, Consumers Energy filed a request with the Michigan Public Service Commission for a revenue decoupling mechanism for the recovery of fixed costs that do not vary with throughput, a residential energy efficiency and conservation program, and an annual true-up mechanism for uncollectible expenses.

Minnesota - Northern States Power (a Unit of Xcel Energy)

Northern States Power has proposed to implement a partial decoupling mechanism to reflect the annual non-weather related effect of the change in average actual use per customer from the average use per customer used in the company's last rate case. The mechanism is a per therm rate adjustment for residential customers and has been proposed as a three year pilot program. Northern States will continue to participate in Minnesota's state-wide conservation program. The Minnesota Department of Commerce recommends that the commission deny the company's decoupling proposal and consider opening a generic docket on decoupling. A decision is expected in December of 2007. In addition, a bill is pending at the Minnesota state

legislature that includes language allowing one or more utilities to file a decoupling pilot program.

New Mexico – Public Service Company of New Mexico

On May 30, 2006, Public Service Company of New Mexico filed a rate case in which it requested a decoupling mechanism that would be adjusted monthly, with an annual true-up, to allow the company to recover revenue lost due to conservation efforts. The monthly adjustment would be shown on the customer bill as a separate line item.

New York – National Fuel Gas Distribution Co.

On January 29, 2007, National Fuel Gas Distribution Co. filed a rate case in its New York jurisdiction in which it requested a decoupling mechanism. Beginning in 2009, the mechanism would allow the company to implement a surcharge and credit mechanism, through which it would be able to recover lost margin associated with conservation savings generated during the 2008 test year. As part of that decoupling proposal, National Fuel seeks to establish a Conservation Incentive Program with three main components: (1) a low income usage reduction program that would provide insulation and efficient appliances for qualified low income customers; (2) a high efficiency appliance rebate program for residential and small non-residential customers; and (3) a general customer conservation education and outreach effort with a specific low-income customer component that recognizes that low income customers are among the highest consuming residential customers.

The decoupling mechanism would apply to residential and small consumption (less than 5000 Mcf annual) customers. The company has requested that if the decoupling mechanism is not approved, that its ROE be increased. National Fuel states that most members of the proxy group used to calculate the company's ROE already have a revenue decoupling program, and the company assumed that it would receive approval for decoupling when it supported its ROE request.

Tennessee – Chattanooga Gas

On November 20, 2006, Chattanooga Gas Co. settled its base rate case in which it proposed to implement an energy conservation program, a conservation and usage adjustment mechanism, and a bare steel and cast iron pipeline replacement program. The company dropped its request for the pipeline replacement tracking mechanism, and the company and the commission agreed to consider separately, in Phase II of the case, the conservation and usage adjustment and the energy conservation program. A final decision about a decoupling mechanism is expected in April of 2007.

Virginia – Washington Gas Light

Washington Gas Light (WGL) initiated a base rate case on September 15, 2006, in which it proposes to implement a revenue normalization adjustment designed to eliminate the effect on revenue collections of deviations in customer usage caused by variations in weather from normal levels and conservation programs.

STATEWIDE INVESTIGATIONS

Arkansas

On January 11, 2007, the Arkansas Public Service Commission adopted energy efficiency rules in a proceeding in which the commission investigated the adequacy of existing efficiency programs for the state's electric and natural gas distribution utilities. According to the adopted rules: (1) the utilities must file for commission approval of a portfolio of initial energy efficiency

programs by July 1, 2007, that are to remain in place from October 1, 2007-December 31, 2009; (2) the utilities are to demonstrate the cost savings expected to be achieved through these programs; (3) these programs may include incentives to encourage efficiency investments by customers; (4) all programs filed with the commission should be "fuel neutral"; (5) the utilities are permitted to request cost recovery of efficiency programs through a separate surcharge; (6) subsequent efficiency programs are to remain in place for terms of up to three years; and (7) the utilities are required to annually submit to the commission a report that addresses the performance of their energy efficiency programs.

Delaware

In March 2007, Delmarva Natural Gas settled its gas base rate case with the Delaware Public Service Commission and the parties agreed to investigate the development of a decoupling mechanism through a statewide process with all parties reserving all rights to argue that a ROE adjustment or some other adjustment may or may not be appropriate if a decoupling mechanism is adopted. While the rate case did not propose a conservation component, as part of the company's recent, "Blueprint For the Future" filing, the company did include rebate programs for DSM and energy conservation programs for gas and electric customers in Delaware.

Indiana

In 2006, the Indiana Utility Regulatory Commission decided two case-specific decoupling proposals, one in favor of Vectren and one opposed to Citizens Gas. The commission noted the variation that fits underneath the broad umbrella of decoupling, and because of the importance of the decoupling mechanisms in promoting utility stability and conservation benefits to customers, the commission initiated a formal inquiry into rate design alternatives and energy efficiency measure for natural gas utilities. The inquiry will address standardization of decoupling mechanisms as well as information to be filed with the commission; the benefits of decoupling to both the utility and the consumer; whether decoupling should include conservation or normal temperature adjustments; and the impact of implementing decoupling mechanisms for both the utility and the consumer. A series of technical conferences will be held to discuss the issues.

Iowa

On February 9, 2006, the Iowa Utilities Board initiated an inquiry into the effect of reduced natural gas usage resulting from increased energy efficiency and other factors on the non-gas revenues of the state's natural gas utilities. In its last rate case, Aquila asked the commission for a rate mechanism that would have decoupled a portion of its rates. While the Iowa Utilities Board denied Aquila's request, it stated that it is open to other decoupling proposals.

New York

The state of New York is investigating the potential gas delivery rate disincentives against the promotion of energy efficiency, renewable technologies and distributed generation.

Pennsylvania

On October 11, 2006, the Pennsylvania Public Utility Commission opened an investigation of conservation, energy efficiency activities, and demand side response by energy utilities and ratemaking mechanisms to promote such efforts. There are three main components to the investigation: (1) what are energy utilities' current efforts to assist their customers to reduce usage, increase energy efficiency, and implement demand side response programs (including implementation of time-based rates), and whether additional cost effective and reasonable steps can be taken to increase those efforts materially (and, if so, the nature of those activities and the costs that the utility or other entity and customers would incur to implement them); (2) whether

advanced metering infrastructure should be developed by Pennsylvania utilities, and, if so, the timeline and standards that should be established for the implementation of these systems for the various customer classes and the methods of sharing this information with customers, competitive energy suppliers, and other customer representatives; and (3) whether revenue decoupling or other similar mechanisms are necessary or appropriate to assure that energy utilities, and in particular natural gas utilities, aggressively encourage and implement conservation and energy efficiency in their service territories, and whether such mechanisms are fair to customers and otherwise in the public interest. A report expected on or before May 15, 2007.

RESOURCES: COMPANIES, RATE ORDERS, WEBSITES, CONTACTS, ETC.

Arkansas – Generic Investigation Opened, Docket No. 06-004-R, January 12, 2006

Atmos Energy – Missouri – Approved – Missouri Case No. Feb. 22, 2007, Contact Pat Childers at 615-771-5877

Avista Corp. – Washington – Approved – Docket No. UG-060518, January 2007; Contact Kelly Norwood @ 509-495-4267

Baltimore Gas & Electric – Maryland – Approved – Maryland Case No. 8780, Feb. 2005, http://webapp.psc.state.md.us/Intranet/CaseNum/NewIndex3_VOpenFile.cfm?ServerFilePath=C%3A%5CCasenum%5C8750%2D8799%5C8780%5C049%2Edoc, Contact Laurie Duhan @ 410-265-4031

Cascade Natural Gas – Oregon – Approved - Docket No. UG 167, April 19, 2006, <http://apps.puc.state.or.us/orders/2006ords/06-191.pd>; Contact Jon Stoltz @206-624-3900

Cascade Natural Gas – Washington – Approved – Docket No. UG-060256, January 12, 2007; Contact Jon Stoltz @206-624-3900

CenterPoint – Arkansas – Petition Pending – Arkansas Docket No. 06-161- U; Contact Chuck Harder at 713-207-7273

Chattanooga Gas – Tennessee – Petition Pending –Tennessee Docket No. 06-00175; Contact Scott Carter at 404-584-4136

CMS – Michigan – Petition Pending – Michigan Case No. U-15190, February 7, 2007; Contact Lisa Johnson at 517-482-6744

Delmarva – Maryland – Statewide Investigation Pending – Regulatory Docket No. 59; Contact Bill Moore at 302-354-1811 or at bill.moore@pepcoholdings.com

Indiana Utility Regulatory Commission – Generic Investigation Opened – December 1, 2006, Cause No. 43180

Iowa Utilities Board – Generic Investigation Opened – July 11, 2006, Docket No. NOI-06-1; http://www.state.ia.us/government/com/util_private/Orders/2006/0711_noi016.pdf

National Fuel Gas Distribution Co. – New York – Case Pending - 07-G- 0141, January 29, 2007; contact Eric Meini @ 716-857-7805

New Jersey Natural Gas – New Jersey – Approved – October 12, 2006, Docket No. GR05121020; <http://www2.njresources.com/news/trans/newsrpt.asp?Year=2005>; Contact Annemarie Peracchio @ 732-938-1129

New York Public Service Commission – Generic Investigation Opened – June 26, 2006, Case No. 06-G-0746 - In the Matter of the Investigation of Potential Gas Delivery Rate Disincentives Against the Promotion of Energy Efficiency, Renewable Technologies and Distributed Generation

NW Natural – Oregon – Approved - Order No. 05-1041, September 26, 2005; <http://apps.puc.state.or.us/orders/2005ords/05-1041.pdf>, Contact C. Alex Miller @ 503-721-2487

Pacific Gas and Electric Co. – California – Approved – December 30, 1981, California Decision No.93887

Pennsylvania Public Service Commission – Generic Investigation Opened – October 11, 2006, Docket No. M-00061984

Peoples Gas and North Shore Gas – Illinois – Petition Pending, March 9, 2007; Contact Valerie Grace at 312-244-4466 or vgrace@pecorp.com

Piedmont Natural Gas – North Carolina – Approved – Dockets G-9, Sub 499, G-21 Sub 461, G-44 Sub 15, November 3, 2005; <http://ncuc.commerce.state.nc.us/docksrch.html>, Contact: David Carpenter @ 704-364-4242

Public Service Company of Colorado – Colorado – Petition Pending – Docket No. 06-656G, December 1, 2006; Contact Ron Darnell at 303-294-2180 or ron.darnell@xcelenergy.com

Public Service Company of New Mexico – New Mexico – Case Pending – Docket No. 06-00210-UT, May 30, 2006; Contact John Fernald @ 505-241-2879

Questar Gas – Utah – Approved –Docket No. 05-057-T01, October 6, 2006; http://www.questar.com/news/2006_news/01-27-06.pdf, Contact Barrie McKay @ 801-324-5491

South Jersey Gas – New Jersey – Approved – Docket No. GR05121020, October 12, 2006; Contact Sam Pignatelli @ 609-561-9000 x4204

Southwest Gas – California – Approved – California Application No. 02-02-012, Decision No. 04-03-034; Contact Roger Montgomery @ 702-876-7321

UNS Gas – Arizona – Petition Pending – Arizona Docket No. G-02404A-06, July 13, 2006

Vectren Energy Delivery – Indiana – Approved – Indiana URC Cause No. 42943, December 1, 2006; Contact Scott Albertson @ 812-491-4682

Vectren Energy Delivery – Ohio – Approved – Case No. 05-1444-GA-UNC, September 13, 2006; <http://dis.puc.state.oh.us/DMPDFs/GWFLPPVGK@LU501L.pdf>; Contact Jerry Ulrey @ 812-491-4138

Washington Gas Light –District of Columbia – Petition Pending –Case No. 1054, December 21; 2006, Contact Paul Buckley @ 703-750-5260

Washington Gas Light –Maryland – Approved – Maryland Case No. 8990, October 1, 2005, <http://webapp.psc.state.md.us/Intranet/maillog/orders.cfm> Contact Paul Buckley @ 703-750-5260

Washington Gas Light –Virginia – Petition Pending – Virginia Case No. PUE-2006-00059, September 15, 2006; Contact Paul Buckley @ 703-750-5260

Xcel Energy – Minnesota – Petition Pending; Minnesota Docket No. G002/GR06-1429, November 9, 2006; Contact Amy Liberowski @ amy.a.Liberowski@xcelenergy.com

ADDITIONAL INFORMATION

If you would like more information about a particular program or would like to speak to another AGA member regarding the details of the program, please contact: Cynthia Marple, AGA director of rates and regulatory affairs, cmarple@aga.org or 202-824-7228.

Coming Up

The next edition of the AGA Rate Roundup will cover weather normalization adjustment clauses. If your company offers such a program, please contact Cynthia Marple.

Previous Editions

The December 2006 Rate Round-Up on Revenue Stabilization Mechanisms can be found at: http://www.aga.org/Template.cfm?Section=Rate_Roundup&Template=/MembersOnly.cfm&ContentID=20563.

The June 2006 Rate Round-Up focused on Innovative Rate Designs for Fixed Cost Recovery. Find this Round-Up at:

http://www.aga.org/Template.cfm?Section=Rate_Roundup&Template=/MembersOnly.cfm&ContentID=20563.